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REPORT OF THE PROGRAMME AND BUDGET COMMITTEE

Implementation of the recommendations of the External Auditor for the financial period 1990-1991

Report by the Director-General

Summary

In compliance with Programme and Budget Committee conclusion 92/2, paragraph (e), provides information on the steps taken by the Secretariat to implement the recommendations contained in the report of the External Auditor (IDB.10/4) for the biennium 1990-1991. Addresses the specific recommendations of the External Auditor and confirms or elaborates the comments of the Director-General thereon.

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Introduction

1. In its conclusion 92/2 requesting the Director-General to report on the steps taken towards implementation of the recommendations of the External Auditor in his report for the biennium 1990-1991 (IDB.10/4), the Programme and Budget Committee emphasized the audit observations related to the following areas: (a) regular budget implementation control by the policy-making organs (PMOs); (b) presentation of future regular budgets on a gross and net basis; (c) adjustment of the budgetary, accounting and financial reporting procedures; and (d) the Internal Audit Unit of the Organization. The Director-General is appreciative of the constructive observations and recommendations of the External Auditor designed to strengthen financial and managerial procedures. Those recommendations will be implemented as explained in the following chapters.

2. Additional comments of the Director-General are provided in document IDB.10/11 on a number of specific points as well as in document IDB.10/11/Add.1 on the recommendations of the External Auditor concerning net basis budgeting.

I. MODALITIES OF POLICY-MAKING ORGAN BUDGETARY CONTROL

3. The External Auditor, in paragraph 18 of his report (IDB.10/4), addresses the issue of appropriate modalities of budgetary control by the PMOs. The suggestion is made by the External Auditor that consideration be given to PMO budget implementation control along programmatic component lines rather than by major objects of expenditure. Control by major objects of expenditure is the operative mechanism provided for under financial regulations 4.3(b) and (c).

A. Programme and budget proposals

4. The new format of programme and budgets adopted for 1992-1993 recognized the importance of linking the activities, objectives and outputs of

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UNIDO programmes with the financial inputs required to effect implementation. Those financial inputs for 1992-1993 are detailed by major objects of expenditure.

5. In that respect, the programme and budgets of UNIDO are presented on a programme budget basis which places emphasis on objectives and planned outputs. This basis is generally recognized as being more effective in achieving results than are expenditure-based budgets that focus on individual financial inputs.

6. In addition to approving the programme and budgets for 1992-1993 contained in document GC.4/42, the General Conference appropriated funds under the regular budget to the major programmes of UNIDO (GC.4/Res.27). That approval is in line with a programme budget approach in that it provides an estimate of the total cost of carrying out the programme of work of individual major programmes. The detail of the estimates analysed by major objects of expenditure, which form an integral part of the programme and budget proposals are of secondary importance to the total cost of the programme of work.

B. Programme and budget implementation

7. The shift in the basis for budgetary control by policy-making organs would require that the focus of financial regulations 4.3(b) and (c) should shift from its current concentration on individual major objects of expenditure to monitoring expenditures deployed for the attainment of objectives and outputs.

8. A change in the buogetary control mechanism would provide the Director-General the authority to commit financial resources within approved appropriations while permitting a flexible and efficient composition of such resources to achieve an effective implementation of the programme.

9. The question arises as to which level of the budgetary structure would be appropriate for the exercise of financial control by the policy-making organs. The spirit of the External Auditor's recommendation is to shift control from looking at the means to assessing the use of resources for the achievement of ends, while at the same time affording to the Director-General a degree of flexibility in choosing the composition of inputs to attain those ends. In conformity with that intent, it is recommended that policy-making organs exercise their control at the level of major programme (departments) rather than at the programme (divisions) or subprogramme (sections or branches) level. This recommendation is made for three reasons. First, the basic operational objectives of the Organization are expressed at the level of major programmes. The subordinate programmes and subprogrammes present specifics through which those major programme objectives are to be attained. It is felt that policy-making organs should, in the context of controlling budgetary implementation, concentrate on the use of resources in meeting the basic operational objectives at the major programme level. Second, following from that point, it may be borne in mind that the preparation of the budget for a given biennium is initiated about two years before that biennium. The budget for any biennium therefore expresses the Director-General's views of how to respond to foreseen needs, well before the actual implementation of that budget. In all likelihood, there would be changes in the demands placed on the Organization, requiring an adjustment of resource allocations from those envisaged two years before. While control at the major programme level would afford a degree of flexibility, control at subordinate levels would severely restrict, if not abolish, that flexibility. Third, it bears mentioning that there are 37 programmes and 93 subprogrammes in the prevailing budget structure. Reporting and controlling budgetary performance at either of the subordinate levels of detail would in all likelihood be unnecessarily complex and, more important, while presenting a great degree of detail, it might inhibit an overview of the utilization of the Organization's resources in relation to fundamental objectives.

C. Financial regulations

10. The change in emphasis from input-based budgetary implementation to a system which permits a more flexible use of resources to achieve programme objectives would require an amendment to the financial regulations. Under financial regulations 4.3(b) and (c), the words "major object of expenditure" would be replaced by "major programme". The amended financial regulation 4.3(b) and (c) would read as follows:

Regulation 4.3

"(b) No transfer between major programmes within the regular budget may take place, except when approved by the Conference in accordance with Regulation 3.11.

"(c) Transfers within each major programme of the regular budget, including transfers between major objects of expenditure, may be made by the Director-General, who as soon as possible shall inform the Board thereof, through the Programme and Budget Committee, provided that in the first fiscal period following its creation, a Professional-level post may not be transferred to another programme or subprogramme."

11. To ensure consistency between financial regulations, it is further proposed that regulation 3.4(a) include a reference to major programmes. This would bring the regulation into line with the present programme and budget format. Financial regulation 3.4(a) would read:

Regulation 3.4(a)

"The regular budget shall be presented at the levels of major programmes, programmes and subprogrammes for expenditures as well as into sections for income. It shall also be presented by major objects of expenditure. It shall be accompanied by such information annexes and explanatory statements as may be requested by the General Conference (hereinafter referred to as the "Conference"), the Board or the Programme and Budget Committee as well as such annexes as the Director-General may deem necessary or useful. The regular budget also shall be accompanied by a statement on the main changes in comparison with the previous biennium".

II. GROSS AND NET BASIS BUDGETING

12. The comments of the External Auditor on the subject of net basis budgeting are to be found in paragraphs 19 and 79 to 84 of his report (IDB.10/4). The Director-General, in his comments thereon (IDB.10/11/Add.1), provided information on the background to the development of the net basis budgeting which was introduced for the biennium 1992-1993. In accordance with conclusion 92/2 of the Programme and Budget Committee requesting the Director-General to take into consideration the observations in the report of the External Auditor, the draft programme and budget proposals for 1994-1995 will be prepared on a gross and net basis. The presentation of income and expenditure estimates will be made in conformity with all relevant financial rules and regulations and will adhere to the principle of universality of budgets, whereby all transactions with third parties having a financial impact are included in the appropriations and approved income estimates.

13. The presentation of the 1994-1995 estimates of gross expenditures, income and net budgets will follow the same basic format as that adopted for the current biennium, which has met with general approval by Member States. In the 1994-1995 budget document, the 1992-1993 budgets will be presented on a gross and net basis in order to facilitate comparison with gross and net figures for the 1994-1995 biennium.

14. As indicated in the report of the Director-General on net basis budgeting (IDB.10/11/Add.1), the change in the presentation of budgetary estimates from a net basis to a gross and net basis will have no financial implications to the Organization or Member States. Member States should, however, take into account the level of income for reimbursable activities when considering the individual major programme estimates in the proposed programme and budgets.

III. BUDGETARY, ACCOUNTING AND FINANCIAL REPORTING PROCEDURES

15. The comments and recommendations of the External Auditor on adjustments required to the accounting procedures of the Organization are contained in paragraphs 11 to 22 and 38 to 106 of his report (IDB.10/4). Steps taken towards implementation of the recommendations are outlined in the following paragraphs under the subject areas identified by the External Auditor.

A. Regular budget "other income"

16. The programme and budget document for the biennium 1992-1993 (GC.4/42 and Corr.1) includes separate subprogrammes for the major cost-shared activities within UNIDO. These cost-shared activities are identified in the Department of Administration (Buildings Management, subprogramme 843) and the Department of External Relations, Public Information, Language and Documentation Services (EPL) (Languages and Documentation, programme 730). The separate identification of those cost estimates will address the concerns of the External Auditor in that any proposal to redeploy funds within major objects of expenditure in accordance with financial regulation 4.3(c) will need to take account of the impact of such redeployments on budgeted income. Prior to the consideration of redeployment proposals by the Director-General a determination of the potential impact on budgeted income will be made.

17. The accounting for cost-shared buildings management expenditures and language and documentation expenditures under separate subprogrammes will also assist the Secretariat to comply with the recommendations of the External Auditor that incomes related to a fiscal period be accrued in accordance with financial rule 110.9 (IDB.10/4, paras. 14 and 55-59).

B. Appropriations and expenditures by major objects of expenditure

18. Prior to the 1992-1993 biennium, budget proposals and financial performance reports on budgetary implementation included expenditures detailed by objects of expenditure. The audited accounts of the Organization for each fiscal period, on the other hand, presented expenditures detailed under major object of expenditure categories.

19. In line with the recommendations of the External Auditor (IDB.10/4, paras. 16-17 and 62-66), it is the intention of the Secretariat to present future reports to the policy-making organs detailed by major programme and major object of expenditure.

20. The new format for the programme and budgets introduced for the 1992-1993 biennium presents estimates under major programme and major object of expenditure categories. The presentation of the estimates in the new format provides the opportunity of comparing expenditures against appropriations by major programme and major object at all stages of budgetary formulation, financial performance reporting and accounting for a fiscal period.

21. The Secretariat intends to present a financial report of savings on unliquidated obligations for the 1990-1991 biennium to the Programme and Budget Committee at its ninth session (in 1993). The report will be presented by major programme and major objects of expenditure. In future, financial reports of savings on unliquidated obligations from the previous biennium will be submitted to the first Programme and Budget Committee session in the second year of the biennium.

C. Accounts payable

22. In response to the comments of the External Auditor on the recording of payables (IDB.10/4, paras. 20 and 85-90), a review has been made of the procedures for recording by the Secretariat of obligations and creditors' invoices. The current systems and procedures for raising and recording obligations, including accounts payable, are considered adequate to ensure that all material expenditure items are allocated to the relevant accounting period. While it is theoretically possible for invoices concerning small amounts not subject to prior obligation (less than $1,000) to be recorded and charged in a subsequent period, there is no likelihood that these charges could affect the integrity of the accounts. Since invoices are received and processed by a number of different UNIDO units before being passed on to

the Accounts and Payment Section, a system of centralized registration would require the assignment of additional staff to this specific task. The cost-benefit ratio of this innovation is, in the view of the administration, certain to be strongly negative. The Secretariat intends to discuss the matter again with the External Auditor.

IV. INTERNAL AUDIT FUNCTION

23. The Director-General is pleased to report that the following steps have been taken towards implementation of the recommendations contained in the report of the External Auditor with respect to the internal audit function (IDB.10/4, paras. 181-189):

(a) A Director-General's bulletin (UNIDO/DG/B.157) was issued on 2 July 1992 setting out the purpose and policy of the Secretariat with regard to internal auditing activities. The internal audit function of the Secretariat, described in the bulletin, ensures its operational independence, impartiality and effectiveness;

(b) A General Service post has been redeployed to the Internal Audit Service (formerly the Internal Audit Unit) and recruitment action is currently under way. The Director-General recognizes the need to redeploy additional Professional and General Service posts to the Internal Audit Service. However, a further increase in the staffing level of the Service is seriously constrained by the prevailing financial situation. Efforts will nevertheless be continued to identify staff resources that can be redeployed to the Service.

V. ACTION REQUIRED OF THE BOARD

24. The Board may wish:

(a) To take note of the steps taken to implement the recommendations of the External Auditor as described in the present report; and

(b) To recommend to the General Conference at its fifth session the adoption of the proposed amendments to financial regulations 3.4(a) and 4.3(b) and (c) as described in paragraphs 10 and 11 of the present document.